

Internal Revenue Service
memorandum

CC:TL-N-1706-86

Brl:JCALbro

date: **APR 24 1986**

to: District Counsel, St. Louis CC:STL
Attn: Bob Burbank

from: Director, Tax Litigation Division CC:TL

subject: Notice of Final Partnership/S Corporation Administrative Adjustment

Your request for technical advice which was directed to the Director, General Litigation Division, by memo dated December 24, 1985, was referred to this Division on January 10, 1986, for response.

I. Issue

Upon the issuance of an FPAA/FSAA 1/, how much information regarding partnership adjustments should be provided and how should such information be conveyed? RIRA No. 6223.00-00.

II. Conclusion

Listing the overall title of the adjustment and the amount is insufficient information. Each person or group with a right to petition a court disputing the adjustments must receive sufficient information to determine whether the adjustments are correct or whether they should litigate any issue. The FPAA should include a computation of the adjustment at the partnership level with a breakdown by partnership items and amounts. A paragraph format explanation of the adjustments, equivalent to the explanation usually provided with a notice of deficiency, should be given. A Form 4605 (Examination Changes) should be included with the FPAA/FSAA to explain and compute the various partnership item adjustments. The same 4605 prepared at the time of the 60-day letter (L-1827) may be reissued with the FPAA/FSAA only if no substantive changes have occurred in the

1/ For brevity, we will usually refer only to the FPAA.

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interim with regard to any actual adjustments or the explanation thereof. In addition, a paragraph explanation of the proposed adjustments should be provided on Form 886-A (Explanation of Items).

III. Facts

Your office reviewed a standard Notice of Final Subchapter S Administrative Adjustment, which included on the back under a heading "Schedule of Adjustments", a one-line description of the adjustment and the amount of the adjustment at the Subchapter S level. Your office responded to Quality Review Staff that the FSAA or FPAA should include a computation of the adjustment at the partnership or Subchapter S corporation level, and an explanation of the adjustment equivalent to explanations which are provided with statutory notices of deficiency. Quality Review Staff responded that providing such an explanation of adjustments would create an unnecessary administrative burden, and your request for technical advice followed.

Current administrative procedure with regard to TEFRA partnerships and Subchapter S corporations is as follows:

1. When a revenue agent determines that partnership adjustments are necessary, an L-1807 (30-day letter) is mailed to the Tax Matters Partner (TMP) offering a closing conference. A copy of the revenue agent's summary report is enclosed, and the letter advises the TMP that a copy of the report and certain other information must be provided to each partner. Also enclosed with the L-1807 is a Form 4605, "Examination Changes - Partnerships, etc." This form provides space to list items which are being adjusted, and contains space for remarks.
2. If, subsequent to the closing conference, the case is still unagreed, or if no closing conference is held, an L-1827 (60-day letter) is mailed to all notice partners. The Form 4605 and the examination report (generally, but not necessarily the same as the summary report issued with the L-1807) is provided to the TMP

along with the 60-day letter (L-1827). The L-1827 notifies the partners that they have 60 days to file a protest, and they are further advised that if they request a copy of the examination report from the TMP and are unable to obtain a copy, the Service will provide one.

3. If no protest is filed, or if after appellate consideration the case is unagreed, an FPAA (L-1830) or FSAA (L-1828) is mailed to the TMP and copies are mailed to the notice partners. Section 6223(a)(2). A one-line description of the adjustment and the amount of the adjustment is provided on the back of the FSAA (L-1828). The FPAA (L-1830) was revised in October 1984, and the Schedule of Adjustments was removed from the back of the letter. Therefore, a Form 870-P is mailed along with an FPAA. Form 870-P contains a heading "Schedule of Adjustments", and a one-line description of the adjustment, and the amount of the adjustment to the partnership return is provided under the heading, e.g., gross receipts - \$50,000.

The Chief, Quality Review Staff believes that requiring the Review Staff to write explanatory paragraphs would create an unnecessary administrative burden on the Service. He argues that "it is the examination report, not the schedule of adjustments, that is intended to provide...information" with regard to the adjustments. The memorandum also suggests that the administrative burden would be lessened by giving each of the notice partners a copy of the examination report and the Form 4605 as part of the FPAA/FSAA. The memorandum points out, though, that providing the examination report undercuts the position taken in the form letters, that it is the TMP's responsibility to provide the other partners with whatever information they need.

IV. Discussion

The FPAA is the document which provides formal notice of the Commissioner's final partnership administrative adjustment(s), and pursuant to section 6226, functions as a "ticket" to court for filing a petition for readjustment of any partnership items. Should a petition not be filed, either by the TMP within 90 days after the FPAA was mailed or by a notice partner within the subsequent 60 day period (section 6226(b)), the FPAA gives the Commissioner the right to assess and collect the resulting deficiencies. Therefore, the FPAA serves as the legal basis for any contemplated court action challenging the Commissioner's determinations with regard to a partnership audit.

T.C. Rule 241(d)(vii), which requires that a copy of the FPAA be attached to the petition for readjustment of partnership items, is essentially identical to T.C. Rule 34(b)(8), which concerns the notice of deficiency. T.C. Rule 241(d)(vii) provides:

A copy of the final partnership administrative adjustment, which shall be appended to the petition, and with which there shall be included so much of any statement accompanying the notice as is material to the issues raised by the assignments of error. If the notice of final partnership administrative adjustment or an accompanying statement incorporates by reference any prior notices, or other material furnished by the Internal Revenue Service, such parts thereof as are material to the assignments of error likewise shall be appended to the petition.

The Internal Revenue Manual states that the FPAA will be in a format similar to a notice of deficiency, and only partnership adjustments will be identified on the FPAA (not individual partner tax deficiencies). IRM 4472(5). Historically, this explanation has been provided in a paragraph format, either on a blank sheet of paper with a heading "Explanation of Adjustments," or on a Form 886-A (Explanation of Items).

Taken together, it is our opinion that the above rules and provisions establish that the basic requirements and procedures for the notice of deficiency and FPAA are parallel. Accordingly, it is our opinion that a one-line statement of explanation on an FPAA with a total amount of money for the adjustment is insufficient. An explanation provided with an FPAA should be sufficiently detailed so that the partner understands which partnership items are being adjusted, why and in what amount. A reasonably informative explanation is necessary so the recipient of the FPAA can make a rational decision whether to dispute any portion of the adjustments. See H.R. Rep. No. 760, 97th Cong., 2d Sess. 603-04 (1982), reprinted in 1982-2 C.B. 600, 664 (judicial review of FPAA). Basic procedural due process would seem to require, at a minimum, that an FPAA contain an understandable explanation of which items are being adjusted in which amounts and why. Furthermore, as a practical matter, we agree with your analysis that many partners will not have had any contact with the Service with regard to proposed adjustments, and at the conclusion of administrative proceedings they will be largely dependent on the FPAA and related documents for an explanation of the audit results.

Along this line, it is important to note that case law on the sufficiency of the explanation provided in a statutory notice does not bind the Service to any particular form of notice, and cases frequently quote Judge Hand in Olsen v. Helvering, 88 F.2d 650, 651 (2d Cir 1937), that "the notice is only to advise the person who is to pay the deficiency that the Commissioner means to assess him; anything that does this unequivocally is good enough." Yet, although case law establishes that little explanation is required with a notice of deficiency, an important factor is always that the taxpayer had knowledge of the reasons forming the basis for the Commissioner's action, and such knowledge is usually demonstrated by the substance of the taxpayer's petition to the court. See e.g., Abatti v. Commissioner, 644 F.2d 1385, 1389-90 (9th Cir. 1981); Commissioner v. Stewart, 186 F.2d 239, 242 (6th Cir. 1951). Absent demonstrated knowledge of the basis for the Commissioner's action, we believe the court may not have upheld the explanation on the notices of deficiency. See Scar v. Commissioner, 81 T.C. 855 (1983) appeal filed, No. 85-7212 (9th Cir., April 11, 1985) (notice of deficiency issued with reference to a partnership in which petitioner was not a partner). In upholding jurisdiction in Scar, the court admonished respondent that "... while a deficiency notice may be held to provide a sufficient foundation for jurisdictional purposes, it may nevertheless be held to be arbitrary and capricious, with the result that not only is its presumption of correctness destroyed, but the burden of...proof is shifted to respondent." Id. at 862. Respondent was allowed to amend his answer to allege a deficiency with reference to the correct partnership because the same substantive issue was already before the court with respect to petitioner's previous taxable year return. Because no element of surprise was involved, the court saw no prejudice to petitioner and said the same conclusion would not necessarily have been reached absent the ameliorating circumstance of the pending case and indicated that the notice was far from satisfactory.

In summary, the important factor behind the Scar decision was that the court already had jurisdiction over the same issue, and petitioner was not prejudiced by the second deficiency notice. Thus, petitioner not only allegedly had knowledge of the intended basis for the incorrect notice, but was already litigating the same issue. It is our opinion that the court could hold that a notice of deficiency was so arbitrary and capricious as to be invalid where, absent petitioner's knowledge from another source, the notice did not adequately inform petitioner of the proposed adjustment. Knowledge of the Commissioner's reasons for making adjustments is required and certainly with regard to individual taxpayers there is less need for reliance solely on a notice of deficiency for such knowledge

because of their involvement in the audit process. With a TEFRA partnership audit, an FPAA takes on more importance than a notice of deficiency as a source of knowledge of the reasons for adjustments. An FPAA must serve as a source of information to the notice partners, who may not have participated in the administrative process and may lack knowledge of the reasons for adjustments. There is no basis for providing less explanatory information than is usually provided in a notice of deficiency.

As a final point, we also disagree with Quality Review's conclusion that a copy of the examination report could be provided to notice partners with the FPAA in order to provide the necessary information regarding the reasons for the proposed adjustments. Not only does the examination report lack the independent legal significance of the FPAA, but procedures otherwise put the responsibility on the TMP to provide a copy of the report to other partners upon request. In addition, the examination report, which is issued with the L-1827 (60 day letter) will not necessarily represent the Commissioner's final position with regard to the adjustments in the FPAA. As discussions continue throughout the administrative process, the final determination and explanation of various issues concerning adjustments may change somewhat.

V. Recommendation

Quality Review Staff recommended providing a copy of the Form 4605 (which was sent with the L-1827 (60 day letter)) to the notice partners with the FPAA, therefore avoiding the necessity for preparing a new explanation of the adjustments. It is our opinion that a Form 4605 does not provide a sufficient explanation of the proposed adjustments. We agree with your recommendation to Quality Review Staff that Form 886-A (Explanation of Items) be used to provide a reasonably informative explanation of the adjustments. In addition, if nothing of substance has changed with regard to the adjustments and explanations thereof as reflected in the Form 4605 which was issued along with the 60-day letter, the same Form 4605 may be included with the FPAA. If, though, any adjustments have changed or any issues have been defined with greater clarity since the 60-day letter was issued, we recommend that the FPAA

(L-1830) include a current Form 4605 which outlines the items being adjusted and the amounts of each such adjustment.

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